BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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In the Matter of	)	
	)	
Implementation of the Local Competition Provisions In the Telecommunications Act of 1996	))))	CC Docket No. 96-98

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REPLY COMMENTS OF THE
UNITED STATES DEPARTMENT OF JUSTICE

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SUMMARY

In these Reply Comments, the Department of Justice reiterates its support of procompetitive policies that will promote efficient entry into local telecommunications markets, and ensure that entrants can operate effectively to bring the benefits of competition to consumers

The Telecommunications Act promotes such competition, in part, by requiring incumbent local exchange carriers ("ILECs") to provide unbundled network elements to competing carriers. Effective implementation of this requirement depends on appropriate pricing of these network elements. The Department believes that the Commission should establish national pricing principles requiring that elements be priced on the basis of total service long run incremental cost, plus forward looking joint and common costs where such costs exist. This pricing standard is based on efficient capabilities of telecommunications networks using the best generally available technology. It should focus on the cost of providing network elements to other carriers, and properly excludes costs attributable to retailing to end users. The Efficient Component Pricing Rule, which would protect the incumbent's monopoly profits, should not be applied in pricing network elements. Neither the Telecommunications Act, nor the constitution, requires the Commission to adopt pricing principles designed to ensure that ILECs recover their historical costs.

Other commenters have proposed restrictions on the availability or use of

network elements. They have argued that elements should be available only to carriers that are partially facilities based, or that elements should not be available for use in providing services comparable to ILEC services that are available for resale pursuant to section 251(c)(4) of the Telecommunications Act. The Commission should not impose such restrictions. By doing so, it would make entry more difficult, and impede competition in the provision of services that are currently priced significantly above cost. In any case, such restrictions would be arbitrary and difficult to enforce.

Finally, in response to suggestions that procompetitive policies might adversely affect the interests of residential customers, the Department has conducted a preliminary analysis of the potential prices for residential telephone service that might result from competitive local markets. The Department's estimates suggest that total payments by residential customers for basic local telephone service and toll service could decline by approximately $12 billion annually in a competitive market. This estimate does not account for many of the potential benefits of increased competition, including lower prices for optional residential services such as call waiting or call forwarding, or the expected reductions in prices for business customers

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I. INTRODUCTION.

In the Comments filed by the Department of Justice in this rulemaking, we urged the Commission to promulgate national standards to guide industry negotiations, states, and the Courts with respect to the interconnection and network elements access rights created by section 251 of the Act, while allowing the states to expand on those rights. The Department also supported the adoption of national pricing principles, based on Total Service Long Run Incremental Costs ("TSLRIC"), plus appropriate, forward-looking joint and common costs, for interconnection and network element access We recommended that the Commission reject a number of suggested restrictions on the interconnection and network elements access rights of entrants into the local exchange and exchange access markets. Finally, we urged the Commission to move promptly to develop new policies for promoting universal service and other important social goals in a manner that does not distort competition in either the local or long distance telephone markets.

In these Reply Comments, the Department further addresses these same themes. We have read nothing in the comments of others that would change our belief that the statutory goal of promoting competition would best be effectuated by the adoption of national TSLRIC pricing principles that also allow for the recovery of forward looking joint and common costs where appropriate. Such pricing principles would exclude monopoly power and inefficiency elements from incumbent local exchange carrier ("ILEC") pricing of unbundled network elements to competing carriers. Contrary to the suggestions of some of the ILECs, neither the 1996 Act nor the Constitution require that the Commission allow the ILECs to recover their historical or embedded costs. As long as the ILECs receive an overall return that maintains their operational and financial integrity, both the statute and the Constitution are satisfied. None of the ILECs have even attempted to offer the specific evidence of financial hardship needed to sustain a statutory or constitutional challenge to the adoption by the Commission of appropriate TSLRIC pricing principles.

The Department recommends that the Commission reject ILEC urgings to limit access to network elements to facilities-based carriers, and to restrict the use of such accessed network elements to the provision of services that are not available for resale under section 251(c)(4). Such restrictions would deny potential ILEC rivals the variety of entry options afforded by Congress in order to expedite and promote entry, and by so doing would retard, if not foreclose, the development of competitive local telephone markets. Such restrictions are designed to, and would have the effect of protecting ILEC pricing from competitive pressures, and in that manner would deprive consumers of the price benefits that Congress sought to provide them. Accordingly, they should be rejected by the Commission.

Finally, the Department has undertaken an analysis of the potential effects on prices for residential telephone service (the beneficiary of cross-subsidies under current regulation) if residential service reflected, as a result of appropriate TSLRIC pricing, the real cost of providing those services. While subject to a number of limitations, our analysis suggests that residential customers, as a group, would derive substantial economic benefits from the development of competition. Moreover, our analysis leads us to believe that the Commission and the states, by adopting competitively neutral policies, will be able to mitigate any adverse effect on the minority of residential customers who might otherwise face higher costs as a result of a transition to pricing at economic cost.

II. THE COMMISSION SHOULD REQUIRE UNBUNDLED NETWORK ELEMENTS TO BE PRICED ON THE BASIS OF PROPERLY DEFINED FORWARD LOOKING INCREMENTAL COSTS.

Many of the comments filed with the Commission recognize that Total Service Long Run Incremental Cost ("TSLRIC"), with or without some additional allowance for properly allocated forward-looking joint and common costs, is the proper basis for determining ILEC prices for interconnection and unbundled elements under section 252(d)(1).[1] It appears from the comments, however, that TSLRIC is not always understood consistently, and that there is considerable dispute as to what additions should be made to TSLRIC on the part of those who view this standard as more of a floor than a ceiling on permissible ILEC prices.[2] The next section of the Department's reply comments addresses and rejects claims

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1 See, e.g., Comments of Michigan Public Service Commission Staff at 13-14; Comments of Public Utilities Commission of Ohio at 41; Comments of AT&T Corp. at 47-50, Comments of Cable & Wireless Inc. at 33-35, Comments of Sprint Corporation at 43-44; Comments of MCI Telecommunications Corporation at 59, 61-62. The Illinois Commerce Commission recognizes that the Commission may develop general cost and pricing guidelines for interconnection and unbundled network elements based upon forward-looking or economic costs rather than historical or embedded costs. Comments of Illinois Commerce Commission at 41.

2 See, e.g., Comments of Ameritech at 63 (advocating that pricing should recover TSLRIC plus joint and common costs and residual costs); Comments of SBC Communications Inc. at 96 (contending LRIC should only be used as price floor and have no other role in determining ILEC prices, while opposing any use of TSLRIC as a floor or ceiling); Comments of U S West, Inc. at 42-43 and attached Affidavit of Robert G. Harris and Dennis Yao at 5 (arguing for LEC prices based on TSLRIC plus shared and common costs, reasonable profit, and embedded costs for a transition period); Comments of Lincoln Telephone & Telegraph Co. at 12 (rates should include LRIC, an allocation of forward-looking joint and common costs, and a share of embedded or historic costs)

that historical costs must be added to TSLRIC and forward-looking joint and common costs under section 252(d)(1). This section seeks to clarify the proper understanding of TSLRIC and what recovery of costs are contemplated under the standard proposed by the Department.

Several commenters have offered definitions of TSLRIC that are generally consistent with the Department's views. For example, AT&T's comments define TSLRIC as "the sum of all of the additional costs that an efficient supplier would incur to supply all of the output of that element that is demanded by all uses and users of that element, assuming that the supplier continued to provide its other network elements, services and functionalities." This standard is focused on the cost of producing "the entire demand for the network elements in question," not merely the individual services that use the elements. It thus includes all efficiently incurred element-specific fixed costs, in addition to the efficiently incurred variable costs. The economic costs to be measured under this approach are "the forward-looking costs of providing the network element in question."[3]

Michigan also has codified a definition of TSLRIC originally adopted by the Michigan Public Service Commission, which properly addresses the key elements of the TSLRIC concept as follows:

> "Total service long run incremental cost" means, given current service demand, including associated costs of every component necessary to provide the service, 1 of the following:

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[3] Comments of AT&T Corp. at 47-48, 55

(i) The total forward-looking cost of a telecommunications service, relevant group of services, or basic network component, using current least cost technology that would be required if the provider had never offered the service.

(ii) The total cost that the provider would incur if the provider were to initially offer the service, group of services, or basic network component.[4]

The Department regards these formulations as reasonable general definitions of TSLRIC, and, with some further allowance for forward-looking joint and common costs if and where they exist, believes that this standard is the most reasonable interpretation of section 251(d)(1)'s mandate that ILEC interconnection and unbundled element prices be "based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network elements," together with the general principle of sections 251(c)(2)(d) and 251(c)(3) that rates for interconnection and unbundled elements be "just, reasonable and nondiscriminatory."[5]

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4 Act 179, § 102(ff), quoted in Comments of Michigan Public Service Commission Staff at 13-14. This TSLRIC definition does not include common overheads or residual costs, but does include development and use of unseparated costs. The Michigan PSC staff has recognized that inclusion of residual costs to work back to embedded investment is inconsistent with the Telecommunications Act's prohibition on use of traditional rate of return pricing. Id. at 14.

5 The Department rejects the spurious construction advanced by some ILECs, e.g., Comments of Bell Atlantic at 37, that the prohibition on setting prices by reference to a rate of return proceeding in section 251(d)(1) was merely intended to relieve the ILECs of the burden of having to defend their rates in "rate case" proceedings. Congress clearly realized that when facing emerging local competition by providers dependent in part on ILEC facilities and services, ILEC pricing behavior would warrant closer rather than less scrutiny and that ILECs should no longer be guaranteed returns based on their book expenditures.

A number of other parties that have sought to define TSLRIC have arrived at similar understandings, whether or not they agree with the application of TSLRIC to determine ILEC interconnection and unbundled element prices.[6] Some of these definitions, however, are not as precise in significant respects as the ones discussed above. For example, GTE defines TSLRIC as follows:

> Total Service Long Run Incremental Cost ("TSLRIC") identifies the forward-looking cost for an entire service offering. TSLRIC is the cost added (or avoided) by offering (or discontinuing) the total service or group of services, holding constant the production of all other services offered by the company. TSLRIC can be thought of conceptually as the difference in the firms [sic] total costs with and without the service. For a single service, TSLRIC consists of the volume-sensitive and volume-insensitive costs.[7]

Cincinnati Bell and US West likewise describe TSLRIC as "the forward looking cost avoided (or added) by discontinuing (or offering) an entire service or group of services, holding constant the production of all other services produced by a firm."[8]

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6 For example, Sprint defines TSLRIC as representing "the incremental costs of an entire product," including "both service-specific fixed costs . . . and volume sensitive costs," as well as "the cost of capital." Comments of Sprint Corporation at 43-44. Sprint also favors allowing the ILECs "a reasonable amount of contribution to shared costs" (i.e., joint and common costs). Id. at 45. MCI defines TSLRIC as the "forward-looking incremental cost of the entire service," the "difference between the forward-looking cost to a firm that provides the particular service along with its other services, compared to the forward-looking costs when it does not provide that service, but still provides the same level of its other services." Comments of MCI Telecommunications Corporation at 64. TSLRIC includes cost of capital, in MCI's view, but does not include any overheads associated with joint or common costs. Id. at 65-67.

7 Comments of GTE Service Corp. at Attachment 2.

8 Comments of Cincinnati Bell Telephone Company at 22; Comments of U S West, Inc, Affidavit of Harris & Yao at 18

NYNEX also defines TSLRIC as "forward-looking incremental costs which reflect all changes in costs caused by the entire service demand."[9] And Ameritech regards TSLRIC as "the specific cost related to a particular service that the firm, using the best available technology, would save if it stopped providing that service entirely, but continued to provide all other services at their current levels," including "all the costs of capital, labor, materials, and other costs that are incurred by the provision of such service, given all the other services the firm is also providing."[10] These definitions, by their focus on services, may tend to blur the distinction between services and network elements or facilities, which becomes important in dealing with the pricing of unbundled elements. The Department believes that with respect to TSLRIC for unbundled elements it is preferable where possible to focus on costs of facilities and network elements rather than services that use those facilities, as this will usually lead to a more accurate determination of costs and reduce the amount of costs that must be treated as joint or common. Several of the definitions proposed by the ILECs also suggest equating forward-looking incremental costs with an avoided cost analysis for discontinuing service, but the Department believes that it is preferable to keep TSLRIC and the avoided cost pricing concepts that apply under section 252(d)(3) distinct, as they could be expected to lead to substantially varying prices in many circumstances.

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9 Comments of NYNEX Telephone Companies at 49.

10 Comments of Ameritech at 63-64.

The Department noted in its initial comments that TSLRIC could differ from the stand-alone costs of providing an element in isolation from all other elements. This would be the case if and where there are economies of scope in the provision of the designated elements. The magnitude of this difference would be affected, as some commenters have recognized, by the range of products the firm produces.

Section 252(d)(1)'s further provision that interconnection and unbundled element rates "may include a reasonable profit" is satisfied, the Department believes, if the TSLRIC standard is understood to incorporate an economic cost concept, and so reflects the cost of capital, but does not allow recovery of any further profits that might be obtained by the exercise of ILEC market power. This point is acknowledged by other major proponents of a TSLRIC pricing standard.[11]

One aspect of the TSLRIC standard that has led to considerable disagreement is the extent to which its forward-looking cost approach should lead to setting ILEC prices based on efficient network designs or use of technologies that the ILECs have not actually implemented. Proponents of TSLRIC properly distinguish between forward-looking economic costs and historical or backward-looking book costs, while also contending that the economic costs to be measured are those of an efficient cost-minimizing competitor using assets that are optimally configured with current technology and efficient practices, and excluding costs

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[11] See, e.g., Comments of Sprint Corporation at 43-44; Comments of MCI Telecommunications Corporation at 65-67.

related to overinvestment or excess capacity.[12] ILECs, in contrast, incline to the view expressed by NYNEX that "for purposes of incremental costing analysis, the only pertinent costs for a particular carrier are the costs that it will incur given the commitments it has undertaken and the facilities that it has already acquired,"[13] and some state regulators also express concern about the "green field" approach to TSLRIC.[14] The Department agrees generally with focusing on an efficient provider standard, rather than a standard under which entrants must pay for existing ILEC inefficiencies. The latter approach could deter network improvements as well as burdening new entrants. While there may be many reasonable disagreements as to how much investment is appropriate for an efficient provider to make, circumstances that could give rise to particular concern would include attempts by ILECs to charge competitors for the cost of facilities that would in fact be used in large part by the ILECs themselves to compete in new markets such as interexchange service.[15] Moreover, the forward-looking TSLRIC for network elements and interconnection should not be based on hypothetical use of new technologies or designs that may not be technically or economically feasible to

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12 Comments of AT&T Corp. at 55-60.

13 Comments of NYNEX Telephone Companies at 53.

14 Comments of Florida Public Service Commission at 26-27.

15 One possible example is the BOCs' "official service" interLATA networks, nominally designed and used in part today for internal operations, but often alleged to contain extensive surplus capacity that could be used to provide competitive long distance services.

implement in the time frame over which prices are determined. TSLRIC should be applied so as to provide a spur for technological laggards to bring their networks up to date, while rewarding those ILECs who successfully develop and introduce new cost-saving technologies and designs not generally available at the time prices were determined.

The Department also believes that it is appropriate to exclude from TSLRIC-based pricing of interconnection and network elements all costs attributable to ILEC retailing of its own services to end users, instead focusing on costs of production of network elements. This approach is reasonable and consistent with the network element rather than service-based approach to TSLRIC.

The TSLRIC standard differs fundamentally from the Efficient Component Pricing Rule ("ECPR") standard proposed by some ILECs.[16] That standard, if adopted, would permit the ILECs to charge their competitors who use their interconnection or unbundled elements "the input's direct per-unit incremental costs plus the opportunity cost to the input supplier of the sale of a unit of input."[17] In the context of present pricing of local telecommunications services, ECPR would give the ILECs the ability to recover from competitors any gains they enjoyed under

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16 See, e.g., Comments of GTE Service Corp. at 63 & n.92 (advocating either ECPR, or Ramsey pricing methods using TSLRIC as a floor and assigning joint and common costs according to demand elasticities of individual elements); Comments of Pacific Telesis Group at 69-71.

17 W. Baumol & G. Sidak, The Pricing of Inputs Sold to Competitors, 11 Yale J. Reg. at 178 (1994).

monopoly but now would fail to realize due to competition, permitting ILECs to charge their competitors higher prices based on ILEC historical and embedded costs, as well as economic rents deriving from the exercise of market power. As the Commission has recognized (Notice ¶ 147), ECPR contemplates recovery of "full opportunity costs, including any monopoly profits." ECPR would not replicate a competitive environment, but rather would penalize competitors for their success and perpetuate inefficient and anticompetitive aspects of the current pricing structure. Indeed, some of the originators of the ECPR concept have explicitly stated in an affidavit submitted in this rulemaking that "applying ECPR to the existing rate structure would result in component prices that lock in the ILECs' monopoly profits and inefficiencies" and have acknowledged that use of ECPR with the existing structure of end-user prices for local telecommunications is inappropriate.[18] ECPR has likewise been rejected as an appropriate pricing standard by some of the ILECs when they have been seeking to enter telecommunications markets dominated by other providers. U S West, for example, has characterized the use of ECPR in telecommunications as "effectively a tool to protect incumbent monopolists."[19] Therefore, the Department supports the Commission's tentative rejection of the proposed ECPR standard for any pricing of

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[18] Affidavit of William J. Baumol, Janusz A. Ordover, and Robert D. Willig at ¶¶ 22-23 (attachment to Comments of AT&T Corp.).

[19] U S West International, "A Framework for Effective Competition: A Response to OFTEL's Consultative Document" at 29 (March 30, 1995).

interconnection or unbundled elements (Notice ¶ 148). The Department further submits, in response to the Commission's inquiry, that pricing on this basis could, in current circumstances, even constitute a barrier to entry under section 253. ECPR pricing, with the current local pricing structure as a baseline, could be expected to result in considerably higher prices being charged to competitors for interconnection and necessary network elements, and would likely lead to higher prices for consumers of telecommunications services.

III. THE COMMISSION IS NOT REQUIRED TO ADOPT INTERCONNECTION AND NETWORK ELEMENT PRICING PRINCIPLES THAT ENSURE THE RECOVERY OF ILECS' HISTORICAL COSTS.

A number of commenters have argued that the Telecommunications Act and/or the Constitution require that any interconnection or network element access pricing rules adopted by the Commission or the states allow the ILECs to recover their historical or embedded costs as distinguished from TSLRIC and appropriate future joint and common costs.[20] Such assertions are incorrect both as a matter of statutory and constitutional law.

Section 251(c) of the Act provides that ILECs must provide interconnection and unbundled access to network elements on rates, terms and conditions that are "just, reasonable and nondiscriminatory . . ." And, section 252(d)(1)(A) provides

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[20] See, e.g., Comments of Bell Atlantic, at 35-40; Comments of U.S. West, at 23-37; and Comments of Ameritech, at 59-77.

that state determinations of whether such rates are "just and reasonable" "shall be - (I) based on the cost (determined without reference to a rate of return or other rate based proceeding) . . . and . . . may include a reasonable profit." Some of those who read this language to require the Commission and the states to allow recapture of historical or embedded costs focus on the word "proceeding." They argue that the statutory bar only prevents the states from determining the justness and reasonableness of rates by a rate of return or other rate based "proceeding."[21] Conversely, they contend that the states must base future rate decisions on the historical costs that are the foundation on which rate base and rate of return regulation is based. We find no support in either the statutory language or its legislative history that supports such an unusual notion. The use of rate base or rate of return methodology to determine carrier-to-carrier prices would have many deficiencies in terms of its complexity, sometimes perverse incentives, and its inability to protect against excessive prices. But the deficiencies lie in the methodology or concept rather than in the proceedings that utilize the pricing methodology. Indeed, using rate of return pricing principles to guarantee utility profits, without employing a proceeding to ensure that ratepayer interests are protected, would destroy the traditional balancing of ratepayer and investor interests. Such a radical change should not be imputed to Congress in the absence of a clear expression of Congressional intent. The 1996 Act contains no such clear

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21 See, e.g., Comments of Bell Atlantic, at 37

expression.

Nor, as some have argued,[22] are the Commission or the states required to allow the LECs to recover all of their historical costs simply because the Act provides that prices "may include a reasonable profit". This argument has a number of flaws. It mistakes "may" for "must", the permissive for the mandatory. From that error, it assumes that there can not be any "profit" until all costs are recovered; therefore, all of a carrier's costs, historical as well as TSLRIC and joint and common must be recoverable. But this argument, among other deficiencies, begs the question. The statute clearly provides discretion to allow a reasonable profit, but that does not answer the question of what "costs" must be allowed before the profit is added. As we have suggested in our Comments, the statutory language, by rejecting the notion of pricing network elements through rate base methods based on historical costs, supports the establishment of pricing principles based on TSLRIC with appropriate forward looking shared costs. Such pricing principles would best replicate the characteristics of competitive markets and, most importantly, facilitate the competitive entry that the Act seeks to promote. By contrast, allowing the ILECs to recover historical costs in future input prices charged to their rivals is likely to both retard entry into local markets and distort long distance competition after RBOC entry therein.[23]

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22 See, e.g., Comments of Ameritech at 77

23 If the Commission concludes nonetheless that the ILECs should be allowed to recover some portion of their historical costs, the states should be required to find

Some commenters argue that failure to allow the ILECs to recover their historical costs would constitute an uncompensated taking in violation of the "due process" clause of Article V of the United States Constitution.[24] The Department submits that such arguments are premature, not demonstrated with sufficient specificity, and overstate the scope of the constitutional guarantee. Consequently, the Commission is not legally prohibited from adopting pricing principles for interconnection and access to network elements that do not, at this time, allow recapture of historical or embedded costs.

The Supreme Court's decision in Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944) articulated the framework in which agency ratemaking is to be tested for compliance with the constitutional ban against uncompensated takings. In Hope, the Supreme Court held that agencies are "not bound to the use of any single formula or combination of formulas in determining rates," Id. at 602, and upheld the agency's reliance on a "historical cost" methodology. Finding that the "just and reasonable" statutory standard mirrored the constitutional requirement,[25] the Court held that the only requirement as to the adequacy of compensation was that the "end result" reflect a reasonable balance of investor and consumer interests. Id. at 603.

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such cost recovery in a competitively neutral manner of finite duration, while preserving TSLRIC pricing for interconnection and network element access pricing.

24 See, e.g., Comments of U.S. West, at 23-37.

25 Id. at 607.

While it allowed the agency to utilize a historical cost methodology in that case, the Hope decision preserved agency discretion to utilize other methodologies as long as the total effect of the rate order could not be said to be unjust or unreasonable. "It is the result reached not the method employed which is controlling . . . It is not theory but the impact of the rate order which counts." Id. at 602. This agency flexibility was reaffirmed in Wisconsin v. Federal Power Commission, 373 U.S. 294, 309 (1963) where the Court stated that "to declare that a particular method of ratemaking is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with the Court's consistent and clearly articulated approach to the question of the Commission's power to regulate rates." And, in Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989) the Court expressly rejected the suggestion that the "prudent investment rule" should be elevated to a constitutional requirement. Instead, it reiterated the broad agency discretion allowed by Hope, id. at 316, and stated that a "rigid requirement of the prudent investment rule would foreclose," among others, methodologies that mimic the operation of the competitive market and thereby provide utilities with incentives to manage their operations efficiently. Id. at 316, n. 10, 308-09. In view of these decisions, suggestions that the Telecommunications Act of 1996 or the Constitution requires the Commission to employ a methodology that allows the recovery of all prudently made (on an a priori basis) investments must be rejected. It is the end result that counts in determining whether investors have been denied their entitlement to reasonable rates, and the Commission is free to adopt a TSLRIC approach that would foster competitive market incentives.[26]

In defining the investor interest that is constitutionally protected, the Court in Hope reiterated prior holdings to the effect that regulation is not invalid merely because it reduces the value of the utility's outstanding stock. Id. at 601. Rates "which enable the company to operate successfully, to maintain its financial integrity, to attract capital and to compensate its investors for the risks assumed certainly can not be condemned as invalid, even though they might produce only a meager return on the so-called 'fair value' rate base." Id. at 605. Subsequent decisions have reaffirmed that test. See e.g. Duquesne, supra at 312, and F.P.C. v. Texaco, Inc., 417 U.S. 380, 391-92 (1974) ("Regulation may, consistently with the Constitution limit stringently the return covered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness.").

The determination of whether an agency's ratemaking violates investor

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[26] We do not read decisions such as Loretto v. Teleprompter Manhattan CATV Corp. 458 U.S. 419 (1982) as changing the scope of agency discretion recognized in Hope and subsequent decisions reaffirming it. Even if one or more of the interconnection, right to unbundled access to network elements, and collocation provisions of the 1996 Act are held to authorize a "physical taking" in constitutional terms, that fact would not limit the Commission's discretion in providing for adequate compensation. There is no indication in the Loretto decision, where the Court expressly refused to consider the adequacy of the one dollar compensation provided by the statute (Id. at 441), that it intended to change the constitutional standards that govern regulatory ratemaking.

rights under the Hope decision and its progeny is fact specific. In Hope, the Court examined the par value of the company's outstanding stock, how much was paid for it, the cash dividends paid during the company's operations, its retained earned surplus, its average earnings as a percentage of invested capital, its depreciation reserves, and its dividend rate, among other financial indicia, and in light thereof determined that the specific annual return permitted by the rate order satisfied the statutory and constitutional requirement -- maintaining the operational and financial integrity of the regulated utility.

None of the commenters in this proceeding who argue that the Commission must allow them to recapture their historical costs provide any specific evidence to support their constitutional argument. Instead, they make only the most general of assertions. That clearly is not sufficient to satisfy the Hope test which requires an agency to carefully analyze the effects of any cost disallowance on investor and consumer interests. Fortunately, the ILECs in this country are generally in good financial condition. As a result, it would be most difficult for the Commission, in advance of the implementation of its pricing principles, to determine on the basis of general assertions that the operating and financial integrity of the ILECs in general would be jeopardized by the utilization of section 251 pricing principles based on a TSLRIC and appropriate joint and common costs approach. Arguments to the contrary are premature; they lack the necessary specificity.

The specificity requirement is particularly appropriate in this proceeding.

Some of the historic investments for which recapture is sought may involve equipment that has multiple uses. To the extent that such equipment has value for unregulated activities of a ILEC, there may not be a need to allow recovery with respect to interconnection or network element access pricing. Even if the unregulated activities are competitive, the ILEC will still earn a competitive return on the portion of the investment devoted to those activities. The fact that there might not be any monopoly profit centers left to allow recapture of "all" the historic investment is not legally determinative. As indicated, supra the constitutional taking issue presents fact specific questions of "how much." Ratemaking does not become confiscatory simply because market forces render unrecoverable some portion of historic costs. Illinois Bell Telephone Co. v. F.C.C., 988 F.2d. 1254, 1263 (D.C. Cir. 1993). If the shortfall is not sufficient to jeopardize the operating and financial integrity of the utility, there is no unconstitutional impairment. In competitive markets, technological changes, shifts in consumer preferences and efficiency advantages of rivals routinely prevent firms from recouping past investments. Such reductions in profits, however, do not necessarily prevent those firms from obtaining needed capital or competing successfully. There is no reason for the Commission to assume, in advance of specific convincing evidence to the contrary, that any profit shortfalls that might result from an inability to recover their historic costs would have a different, more harmful, effect on LECs.

The claims of confiscatory taking in this proceeding are particularly premature in view of the uncertain pace and manner of competitive entry and the presently unknown degree of interconnection and network element utilization that will take place over any given time period. Under some scenarios, the effect on ILECs of not permitting recovery of historical costs could be extremely modest -- well below a confiscatory level. Under other scenarios there might be a more significant effect, but still short of constitutional concerns. And, of course, it is possible that under some scenario there might be a need to allow some recapture.[27] But the consequences of the Commission's pricing principles in this proceeding will only be observable over a period of time. Cf. Federal Power Commission v. Texaco, Inc., 417 U.S. 380, 392 (1974). In the meantime, there is no legal requirement that the Commission utilize carrier to carrier pricing principles that would allow the recapture of historical or embedded costs, especially when to do so would endanger the statutory goal of promoting competitive entry.

IV. THE COMMISSION SHOULD PROHIBIT THE CONDITIONING OF INTERCONNECTION AND NETWORK ELEMENT AGREEMENTS ON PROMISES NOT TO DISCLOSE INFORMATION TO GOVERNMENT AGENCIES.

The Commission has solicited comments (Notice, ¶ 47) on whether ILEC insistence on the inclusion of restrictions on the disclosure of information concerning interconnection or network element agreements should be viewed as

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[27] In which case, we would urge the Commission to make sure that the necessary recapture was implemented in a competitively neutral manner rather than in a manner that could distort local and/or interexchange competitions.